PAPERS

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Donald Trump and Our Fiscal Frenzy: An Economic and Political Challenge for Brazil

Risk assessment and turbulence in the economic-financial future

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Trump's (DT) election does not pose a threat to the planet. The 45th President of the United States and future 47th Commander-in-Chief of the world's largest economy did not exhibit dictatorial or fascist tendencies during his first term, nor does he appear irrational or unstable. However, Trump is firm in his convictions, determined, and guided by nationalism – which is distinct from liberalism. Furthermore, he received a clear popular mandate and is likely to pursue his campaign promises with precision. The conditions for implementing his agenda are highly favorable, given his popular support, backing from the delegates, and his party's majority in both the Senate and the House of Representatives.

In this context, the concerns among the more progressive circles – both economically and socially – are understandable and valid, particularly in light of the often-flexible concepts they advocate. Policies tied to the leftist identity agenda, such as "diversity, equity, and inclusion" (DEI), immigration issues, and various forms of "affirmative action" – which gained momentum during the Biden administration – are likely to face significant setbacks. Indeed, the entire woke culture, with its imposition of moral and ideological values that restrict individual, corporate, and investor freedoms, will come under intense scrutiny. Equally noteworthy will be the shift in economic policy, with expected impacts on financial and commercial markets. These changes in the U.S. landscape and outlook will have considerable repercussions for various countries, whether through direct and indirect effects on trade and financial interactions or through the "influence" and "doctrine" the U.S. exerts – often to varying degrees – on social customs, practices, and policies in other cultures and nations. Historically, such shifts have echoed globally, with far-reaching consequences.

Brazil, currently governed by leftist forces and grappling with severe Institutional dysfunctions, is not only far from aligning with the future Trump administration but also risks facing significant obstacles with the world's largest economy due to its failure to implement necessary economic adjustments. In this context, certain "shocks" are foreseeable in the US, such as a possible increase in tariffs on imports, a more restrictive monetary policy (higher-than-expected interest rates), potentially reduced bilateral trade (with the U.S. being Brazil's second-largest trading partner), and a likely strengthening of the Dollar globally. This could lead to inflationary pressures, particularly in developing countries.

In a potentially more adverse and even "hostile" global scenario, the domestic challenges we face are likely to intensify. The country, having solemnly neglected the need for adjustments, especially in the fiscal area, with the continuous growth of public spending financed by successive increases in debt, seems destined to deepen this unsustainable cycle. The recently announced Fiscal (spending cuts) Adjustments falls far short of what is necessary and, more critically, overlooks the imperative need for significant structural adjustments. Evaluation: "much ado about nothing". Any potential positive market reaction will be fleeting once it becomes evident that there is no effective impact on the structural reduction of expenditures (new projections do not indicate a reversal in the debt-to-GDP trajectory). Moreover, implementation remains uncertain. Plans, projects, and promises have often been "adjusted" down the line, fueling justifiable skepticism.

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Thus, the likelihood of a different outcome is slim, both due to the improbability of this government aligning with the Republicans and the lack of commitment to the adjustments that are genuinely necessary – adjustments which, in truth, were never part of its electoral mandate. A disaster, but a consistent one.

In this context, a potential further depreciation of the Brazilian Real is likely to intensify inflationary pressures, exacerbating the de-anchoring effect and potentially driving an increase across the entire interest rate structure. Indeed, at the short end of the curve, justified by inflation, and at the long end, by worsening fiscal conditions. Growth, already constrained to its Potential GDP (around 2% annually) for 2025, will face even greater limitations, with significant impacts throughout the entire production chain. In the markets, elevated levels of interest rates, exchange rates, and risk premiums could exert substantial pressure on the stock market, which is expected to remain relatively unattractive. A collapse seems imminent.

The Fiscal (Spending Cuts) Adjustments - Summary

Bold for the Government, Insufficient for Brazil

- **Estimated cuts of R$ 70 billion in 2025 and 2026**
- **Rules preserved BPC and Unempl.Insurance/Min. Wage Infl. +2,5%**
- **Wage bonus guaranteed at R$ 2,640, adjusted for inflation**
- **Parliamentary Amendments included in the Fiscal Rule**
- **In case of deficit => extension of Tax Benefits is prohibited**

EXTRA

- **Tax exemption for those earning up to R$ 5,000.00**
- **Tax increase for those earning above R$ 50,000.00**

Preliminary Impact Estimate - Federal Govnt. View (R$ bi)

Measure	2025	2026	2027	2028	2029	2030
PEC (*)	11,1	13,4	16,9	20,7	24,3	28,4
PL (**)/Others	12,7	20,2	25	31,1	38,7	45,5
Amendments	6,7	7,7	7,3	5,6	6	6
Total	***30,6***	***41,3***	***49,2***	***57,5***	***68,6***	***79,9***

(*) Ab. Sal., Fundeb, DRU, FCDF, Subsidies. (**) Min.Wage, Bolsa Fam., BPC, Military, others

Source: Various sites. Elaborated by: Redwood.

In the likely scenario ahead, it is expected that the Brazilian administration will adopt measures consistent with its past actions, based on the frequent statements of the Supreme Leader regarding economic policy and campaign promises. This set of measures will likely reflect well-known strategies to address the context: (i) further expansion of government spending, including "flexibilities" and parafiscal ones, (ii) increased tax rates, and (iii) heavy reliance on agencies, public banks, and pension funds under its control to drive loans, investments, and various capital transactions, among others. This represents the classic recipe favored by several renowned economists from certain universities in São Paulo's interior, often celebrated by developmentalists: *a state-led approach, spending and consuming, and driving money circulation* (money flow), i.e., aggregate demand and the Keynesian multiplier – economic dynamism driven by demand. It is the government and its fiscal impulse perpetuated over time. These initiatives, rooted in narrow and outdated thinking, signal a continuation of policies with the same bias and "strategic orientation" – the harmful consequences of which are all too familiar.

Should such a scenario materialize – which appears increasingly likely – investors must begin careful preparation immediately. As expected, the necessary precautions will be neither simple nor quickly executed. It will be essential to reassess current portfolios, aligning them with country risk tolerance and market exposure, while evaluating real opportunities for reallocation, considering liquidity, interest and opportunities in both domestic and international investment prospects. Above all, the investment time horizon will be a critical parameter in this planning, particularly given that in two years, a "new opportunity" will arise with the presidential elections.

At any rate, the message is unequivocal: Brazil's outlook may have changed substantially. Without haste, it will be crucial to factor this possibility into projections and be adequately prepared should indicators confirm this scenario. However, the government's evident inability to implement the structural reforms needed to ensure long-term economic stability and growth remains a significant obstacle. The lack of strategic vision and technical expertise undermines the development of robust public policies, resulting in suboptimal solutions that merely delay the worsening of underlying issues. They accept the risks, as they are politically trapped and constrained.

Brazil will neither collapse nor become another Venezuela, but the lack of concrete actions and solid planning will hinder its development. The country needs capable leadership, with the expertise to clearly identify problems, move beyond outdated dogmas, and propose and implement solutions that address economic and social challenges effectively. Investors: prevention is helpful but not enough – objectives need not change, but strategies must be revisited.

Trump may bring benefits for the US, but here, the responsibility for our challenges rests squarely on us.

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